IN THE

Supreme Court of the United States

No. .....

October Term, 1958

ELIAS MILLER, PAUL MILLER, ANNA MILLER and HELEN MILLER, and ELIAS MILLER and PAUL MILLER, as Executors of the Estate of GEORGE MILLER, Deceased,

Petitioners,

vs.

IRVING SULMEYER, Trustee in Bankruptcy of the Estate of DELCON CORPORATION, Bankrupt,

Respondent.

Petition for Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit After Judgment in a Bankruptcy Proceeding.

To the Honorable Chief Justice and Associate Justices of the Supreme Court of the United States:

Petitioners pray that a Writ of Certiorari issue to review the decision and judgment of the United States Court of Appeals for the Ninth Circuit affirming the interlocutory order of the United States District Court in the bankruptcy Matter of Delcon Corporation, Bankrupt, pending in the District Court of the United States, Southern District of California, Central Division. The aforesaid interlocutory order of the District Court reversed the decision and order of the Referee in Bankruptcy.

whose decision demonstrates a thorough and scholarly exploration and analysis of the pertinent sections of the Bankruptcy Act in the light of the equity principles rooted in the philosophy of the Bankruptcy Act. The Referee was brought to the conclusion that the facts on which the decision of this Honorable Court in *Moore v. Bay*, 284 U. S. 4, 52 Sup. Ct. Rep. 3, 76 L. ed. 133, was predicated were not analogous or parallel with the legal and *equitable problem presented by the present record.*[1]

Introductory Statement.

Petitioners (referred to herein as Millers) are the owners and holders of a purchase price chattel mortgage on a manufacturing plant and business in Los Angeles, California sold by petitioners to Delcon Corporation (called Delcon) on June 1, 1954. The chattel mortgage was executed and delivered by Delcon to petitioners on June 1, 1954, *more than eight months preceding bankruptcy;* and due to the dishonesty of a trusted employee of petitioners the chattel mortgage was not recorded until August 19, 1954. *On the date of its recordation Delcon was solvent; and the chattel mortgage was recorded more than four months preceding bankruptcy.*

The unpaid balance due petitioners prior to bankruptcy under their purchase price chattel mortgage was in default; and on December 27, 1954, (about two months prior to bankruptcy) petitioners repossessed such of the mortgaged equipment as they could locate. Delcon was not in possession of the mortgaged property *since December 1954.* The bankruptcy petition was filed against it on February 23, 1955.

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[1]The decision in *Moore* and its inapplicability to the present record is discussed *infra.*

During the period intervening between the execution of the chattel mortgage on June 1, 1954 and its recordation on August 19, 1954 (when Delcon was solvent), Delcon became indebted to simple trade creditors in the sum of $8,906.95. The major part of its trade indebtedness was incurred by Delcon after the recordation of the chattel mortgage on August 19, 1954.

On May 6, 1957, an order was made by the Referee declaring that the chattel mortgage was not void against the creditors of the bankrupt who came into existence *after the recordation of the chattel mortgage on August 19, 1954* (herein called late creditors).

On the petition for review filed by the trustee in bankruptcy under Section 39c of the Bankruptcy Act (11 U. S. C. Sec. 66), the order of the Referee was reversed; and on July 30, 1957, an order was made by the District Court declaring that the chattel mortgage was void in its entirety against all creditors of the bankrupt, including the late creditors (albeit, as noted *supra*, the chattel mortgage was recorded when the bankrupt was solvent and more than four months preceding bankruptcy and though under the California law noted *infra*, a chattel mortgage is valid against a mortgagor's subsequent creditors).

Relevant Proceedings in Delcon Bankruptcy Matter.

1. On February 23, 1955, an involuntary bankruptcy petition was filed against Delcon [R. p. 3].

2. On February 23, 1955, the bankruptcy matter was referred to a Referee in bankruptcy [R. p. 6].

3. On March 6, 1955, Delcon was adjudicated bankrupt by the Referee [R. p. 6].

4. On April 25, 1955, respondent was appointed by the Referee trustee of the estate of the bankrupt [R. p. 7].

5. On October 24, 1955, petitioners filed a verified secured claim for the unpaid purchase price due them under their chattel mortgage which was in default [R. p. 8].

6. On July 5, 1956, objections and a counterclaim were filed by the trustee in bankruptcy to petitioners' aforesaid secured claim alleging that the chattel mortgage was void against *all the creditors* of the bankrupt because of the delayed recordation of the chattel mortgage from June 1, 1954 until August 19, 1954 [R. p. 17].

7. On August 21, 1956, petitioners filed an amended answer to the trustee's counterclaim alleging that the Referee lacked summary jurisdiction to award an affirmative judgment against petitioners for the value of the mortgaged property repossessed by petitioners *prior to bankruptcy* under the terms of their purchase price mortgage [R. p. 23], based on Delcon's default.

8. The Referee's decision was filed February 8, 1957 [R. p. 53]; and his ensuing order was entered May 6, 1957 [R. p. 59].

9. The order of the District Judge reversing the Referee and ordering judgment against petitioners in the sum of $82,500.00 (less some minor credits) was entered July 30, 1957 [R. p. 63].

10. Notice of Appeal from the order of the District Court to the Court of Appeals for the Ninth Circuit was filed by petitioners on August 12, 1957 [R. p. 70].[2]

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[2]Under Rule 24 of the Bankruptcy Act (11 U. S. C. Sec. 47) jurisdiction is vested in Courts of Appeals to review affirm, revise, or reverse *interlocutory orders in controversies arising in proceedings in bankruptcy* (*e.g. In re Grenstreet, Inc.*, 209 F. 2d 660).

Opinions and Orders of the Courts Below.

1. The opinion and decision of the Referee are set forth at pages 32 to 53 inclusive of the printed Transcript of the Record.

2. The Order of the Referee declaring that petitioners' chattel mortgage *was valid* against the creditors of the bankrupt who came into existence after the recordation of the chattel mortgage on August 19, 1954 is set forth at page 59 of the printed Transcript of the Record.

3. The conclusions of law and order of the District Court declaring that the chattel mortgage was void in its entirety against all the creditors of the bankrupt under the decision in *Moore v. Bay, supra* (284 U. S. 4), are set forth at pages 67 to 70, inclusive, of the printed Transcript of the Record.

4. The opinion of the Court of Appeals for the Ninth Circuit is officially reported in 263 F. 2d, beginning at page 513; and a copy thereof is appended hereto as Appendix "A." A copy of the Judgment of the Court of Appeals is appended as Appendix "B"; and a copy of the order denying the petitioners' petition for rehearing is appended as Appendix "C."

Concise Statement of the Grounds on Which the Jurisdiction of This Court Is Grounded.

1. The judgment of the Court of Appeals (Appendix "B") affirming the order of the District Court was entered on January 16, 1959 [certified typewritten Record of the Proceedings in the Court of Appeals, at p. 87].

2. A petition for rehearing was filed by petitioners on February 13, 1959, within the time allowed therefor by the Rules of the Court of Appeals; and it was denied on April 17, 1959, without an opinion [certified Typewritten

Record of the Proceedings in the Court of Appeals, at p. 888].[3]

3. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254(1); Section 24(c) of the Bankruptcy Act (11 U. S. C. 47), and under Rule 19 of this Court.

Statutes Involved.

1. California Civil Code Section 2973 official (Deering's), at page 494, reads as follows:

> "Sec. 2973. (*Mortgages valid between parties and others with notice.*) Mortgages of personal property, other than that mentioned in section twenty-nine hundred and fifty-five, (not relevant here) and mortgages not made in conformity with the provisions of this article, *are nevertheless valid between the parties*, their heirs, legatees, and personal representatives, and persons who, before parting with value, have actual notice thereof." (Italics supplied.)

2. California Civil Code Section 2957 official (Deering's), at page 488 is lengthy and the pertinent part thereof is set forth in Appendix "D."

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[3]In their petition for rehearing (forwarded to this Court by the Clerk of the Court of Appeals) petitioners made an alternative request to have the judgment of the District Court modified and to have the case remanded to the District Court with directions to give petitioners the right to petition the District Court or the Referee for a subordination of the claims of the creditors of the bankrupt who came into existence after the recordation of the chattel mortgage to the claims of the petitioners and also to the claims of the creditors of the bankrupt who were in existence prior to the recordation of the chattel mortgage, pursuant to Section 57(K) of the Bankruptcy Act (11 U. S. C. Sec. 93) and in accord with the equitable doctrine of subordination expounded by this Court in *Pepper v. Litton*, 308 U. S. 295, 60 S. Ct. Rep. 238, and in other decisions cited *infra*. Such alternative request was not granted by the Court of Appeals in its order denying petitioners' petition for rehearing.

3. California Civil Code Section 3440 official (Deering's), at page 624, covers sales and mortgages *in fraud of creditors*. It does not deal with the legal effect of a delayed recordation of a chattel mortgage under the California law. (This section was the subject of the decision in the *Moore* decision *supra* (284 U. S. 4).) This section is too lengthy, and the pertinent part thereof is set forth in Appendix "D."

4. Section 60 of the Bankruptcy Act, as amended (11 U. S. C. Sec. 96), covers the subject of *preferences*; and it has no application on the present record since the instant chattel mortgage was recorded more than four months preceding bankruptcy, and furthermore the bankrupt was solvent on the date of its recordation.

5. Section 70(c) of the Bankruptcy Act, as amended (11 U. S. C. Sec. 110(c)) reads as follows:

> "c. The Trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

6. Section 70(e) of the Bankruptcy Act, as amended (11 U. S. C. Sec. 110(e)(1)) reads as follows:

> "e. (1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under

this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor."

7. Section 57(k) of the Bankruptcy Act, as amended (11 U. S. C. Sec. 93), reads as follows:

"k. Claims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part *according to the equities of the case*, before but not after the estate has been closed." (Italics added.)

Questions Presented for Review.

1. Whether preference Section 60 of the Bankruptcy Act (11 U. S. C. Sec. 96) (relied on in part by the Court of Appeals) is applicable to the present record in light of the undisputed evidence that petitioners' chattel mortgage was recorded more than four months preceding bankruptcy (and when furthermore the bankrupt was solvent) and whether the application by the Court of Appeals of Section 60 of the Bankruptcy Act to the present record can be sustained.

2. Whether the decision of this Court in the *Moore* case, *supra* (284 U. S. 4), on which the District Court and the Court of Appeals heavily relied is analogous in principle to the present record in view of the fact that the Moore decision, and the decision of the Court of Appeals in the case at bar rest on divergent factual situations and involve the construction of dissimilar California statutes.

3. Whether the broad strokes and thrust in the *Moore* decision, (based upon a dissimilar factual situation and a dissimilar California statute) were narrowed and limited

by this Court in its subsequent decision in *Buffum v. Peter Barcelou Co.*, 289 U. S. 227, 53 S. Ct. 539, 77 L. Ed. 1140 in their application to the equities presented by this record.

4. Whether petitioners' unconscious delay in the recordation of their chattel mortgage *in absence of fraud* against creditors rendered their valid chattel mortgage void against creditors of the bankrupt who came into existence after the recordation of their chattel mortgage (which took place more than four months preceding bankruptcy) under Section 70(c) and 70(e) of the Bankruptcy Act in the light of the well settled and conceded California law that creditors coming into existence after the recordation of a chattel mortgage cannot attack its validity on the ground of its earlier delayed recordation.

5. Whether the late creditors of the bankrupt and the trustee in their behalf are estopped from attacking the validity of petitioners' chattel mortgage under the doctrine of estoppel *in pais* which courts of bankruptcy do consistently invoke in the exercise of their broad equitable powers.

6. Whether the Court of Appeals erred in failing to give any consideration to the all important equitable doctrine of estoppel *in pais* though it was urged by petitioners at their oral argument in the Court of Appeals and reurged in their petition for rehearing.

7. Whether the Court of Appeals erred in refusing to grant petitioners' alternative request in their petition for rehearing for a modification of its decision and for a remand of the case to the court below with directions to give petitioners the right to petition the District Court or the Referee for a subordination of the claims of the late creditors to those of the petitioners and of the other

creditors under the equitable rule buttressed by Section 57(k) of the Bankruptcy Act (11 U. S. C. Sec. 93).

8. Whether the repossession by the petitioners of the located chattel mortgaged property about two months prior to bankruptcy (which was authorized under the terms of the chattel mortgage) and the subsequent sale thereof by petitioners during bankruptcy to a bona fide purchaser at a fair price, was a conversion of the bankruptcy assets on which to predicate *an affirmative judgment* against petitioners in the sum of $82,500.00.

Statement of the Case.

The sketchy statement of the material facts touched upon slightly in the introduction to this petition are amplified and discussed comprehensively in the Memorandum Decision of the Referee [R. pp. 32-53]. The findings of facts of the Referee were adopted by the District Judge in his Findings of Facts [pp. 63-70]. The record presents solely questions of law involving the construction and interpretation of sections of the Bankruptcy Act in their application to the equities appearing in this record. Briefly summarized for the convenience of this Honorable Court, the facts material to a consideration of the questions presented for review are as follows:

Petitioners (referred to in the Memorandum Decision of the Referee as Millers and as the Miller Family) had extensive business, commercial and financial interests. In and prior to June 1954, they operated a valuable manufacturing business under the firm name of Miller Engineering Company [R. p. 33].

On June 1, 1954, petitioners sold their manufacturing business, including the physical assets located at their plant and the right to use their firm business name to

Delcon. In part payment Delcon executed and delivered to petitioners its promissory note for $189,000.00, payable in installments and which was secured by a chattel mortgage on the physical assets involved in the sale [R. p. 33]. The manufacturing business sold and transferred by petitioners to Delcon was a solid and solvent going concern. The down payment made by Delcon was in the minimal sum of $11,000.00; and as above noted the balance of the purchase price of $189,000.00 was secured by the instant chattel mortgage. The sale was a fair sale; and Delcon came into possession of a going business having a value of $200,000.00 with the minimal down payment of $11,000.00. There is no evidence in the record suggesting fraud against the creditors or a non-compliance with Section 3440 of the California Civil Code. The sale and transfer by petitioners of their going and solvent business to Delcon supplied Delcon with the means of carrying on a valuable trade. (*Cf. In re Mercury Engineering Co.*, 68 Fed. Supp. 376, 380 quoted from in Appendix G.)

Due to the dishonesty of an employee of petitioners who had been in their employ for about seven years and who had been delegated to promptly record the chattel mortgage, the recordation of the chattel mortgage was delayed from June 1, 1954 to August 19, 1954. On August 2, 1954 petitioners learned the first time that their trusted employee was an embezzler. (Opinion of Court of Appeals, App. A.)

The failure of their trusted employee to promptly record the chattel mortgage came to petitioners' attention the first time on August 19, 1954, whereupon the chattel mortgage was recorded by petitioners at once [R. p. 33].

On August 19, 1954, when the chattel mortgage was recorded Delcon was a going and solvent concern.

In December, 1954 Delcon was in default under the terms of the chattel mortgage; and on December 27, 1954 petitioners repossessed such of the mortgaged chattels as they could locate [R. p. 34]. The repossession by petitioners took place about two months prior to bankruptcy; and petitioners were authorized to take possession of the mortgaged chattels upon Delcon's default under the express provisions of the chattel mortgage [R. p. 34].

The repossessed chattel mortgaged property has remained in petitioners' possession since December 27, 1954. In March, 1955 (after the petition in bankruptcy was filed) petitioners sold the located chattel mortgaged property to a bona fide purchaser at a fair price in the sum of $82,500.00.

Between the execution of the chattel mortgage on June 1, 1954 and its recordation on August 19, 1954 (during which time Delcon was at all times a solid and solvent concern) credit was extended to Delcon by trade creditors in the sum of $8,906.95. The major portion of the trade indebtedness incurred by Delcon took place after the recordation of the chattel mortgage; *and the late creditors were charged with constructive notice and knowledge of petitioners' chattel mortgage superior lien.*

Delcon became insolvent in December, 1954 [R. p. 56] and the petition in bankruptcy against it was filed February 23, 1955.

The Referee declared in his Memorandum Decision that the trustee's position that the chattel mortgage was also void against the late creditors (who had constructive notice and knowledge of petitioners' superior chattel mortgage lien) shocked the conscience of the Referee. The Referee was of the view that the late creditors *were estopped in equity and good conscience from attacking*

the validity of the chattel mortgage, and that the Trustee in bankruptcy (who stood in their shoes) was likewise estopped from attacking the validity of the chattel mortgage for the benefit of such late creditors.

The order of the District Judge directed the Referee to enter an affirmative judgment against petitioners in the sum of $82,500.00 (less minor credits). It was affirmed by the Court of Appeals; and in its opinion the Court of Appeals made the unfavorable comment that the trustee sought "a windfall of $82,500.00."

THUS THE LATE CREDITORS (WHO HAD CONSTRUCTIVE NOTICE AND KNOWLEDGE OF PETITIONERS' CHATTEL MORTGAGE LIEN) WOULD BECOME UNJUSTLY ENRICHED TO THE EXTENT OF SAID WINDFALL OF $82,500.00, AS COMMENTED ON BY THE COURT OF APPEALS. NONETHELESS, PETITIONERS' EQUITIES WERE NOT RESPECTED BY THE DISTRICT COURT AND THE COURT OF APPEALS; AND THE EQUITABLE DOCTRINE PRECLUDING UNJUST ENRICHMENT WAS NOT GIVEN ANY CONSIDERATION BY THE DISTRICT COURT AND THE COURT OF APPEALS.

Jurisdiction of the Courts Below.

I. Jurisdiction in the District Court and in the Referee is vested under the provisions of the Bankruptcy Act, and is based on the records and proceedings in the Bankruptcy Matter of Delcon Corporation alluded to *supra*.

II. Jurisdiction in the Court of Appeals is vested under Section 24 of the Bankruptcy Act (11 U. S. C. Sec. 47) and (28 U. S. C. Sec. 1291).

III. The facts disclosing the basis of the jurisdiction of the District Court and of the Court of Appeals are stated in the Findings of Fact and Conclusions of Law of the Referee and of the District Court [R. pp. 53-59; pp. 63-70].

Reasons Relied on for Writ of Certiorari.

I.

The core of the principal question presented for review is whether under Sections 70(c), 70(e) and 60 of the Bankruptcy Act (11 U. S. C. A. Sec. 110, sub. c and sub. e(1); 11 U. S. C. A. Sec. 96) in light of the California law the trustee in bankruptcy was granted the right to attack the validity of petitioners' chattel mortgage (recorded more than four months preceding bankruptcy at which time the bankrupt was solvent) for the benefit of the creditors who came into existence subsequent to the recordation of petitioners' chattel mortgage. This all important question presents a *federal bankruptcy question*, which must be resolved by the decisions of the federal courts (*Moore v. Bay, supra*, 284 U. S. 4; 52 S. Ct. 3. 76 L. Ed. 133; *Cf. Baker v. Texas etc. Co.*, 79 S. Ct. Reporter No. 11 at page 665). The statement in the opinion of the Court of Appeals (263 F. 2d at page 516) that the infirmity of petitioners' chattel mortgage was not cured *against the trustee in Bankruptcy* by their repossession of the mortgaged property based on Delcon's default (which took place about two months prior to bankruptcy) under the California rule of law enunciated in *Noyes v. Bank of Italy*, 206 Cal. 266, needs correction. It is in conflict with the federal rule of law on this subject stated in Appendix "E."

II.

The decision in the *Moore* case, *supra* (the touchstone of the opinion of the Court of Appeals) is not analogous "in principle" to the case at bar in its application to the facts and telltale equities epitomized in the statement of the case *supra* and amplified in the memorandum decision of the Referee [R. pp. 32-53]. The *factual context* in the *Moore* case and the *factual context* in the case at bar are

governed by different principles and are based on the construction of dissimilar California statutes. The decision in the *Moore* case concerned a mortgage which under the California Civil Code Section 3440 then in force was *conclusively fraudulent and a nullity against all creditors of the mortgagor;* while the case at bar concerns a mortgage which under the California Civil Code Sections 2973 and 2957 is *valid against creditors who came into existence after the recordation of the chattel mortgage.* The opinion of the Court of Appeals failed to differentiate realistically the underlying basic facts in the *Moore* decision from the basic underlying facts and *equities* in the case at bar. It would seem that the Court of Appeals was of the view that the broad strokes in the *Moore* decision were applicable to the broad *equitable* issues presented in the case at bar. (Which latter equitable issues were not adjudicated in the *Moore* decision.)

III.

Futhermore, the opinion of the Court of Appeals cannot be reconciled in material aspects with the subsequent decision of this Court in *Buffum v. Peter Barcclous Co.*, 289 U. S. 227, 53 S. Ct. 539, wherein Mr. Justice Cardozo speaking for the Court shed a clarifying light on the precise holding of the *Moore* decision. At page 541 of the Sup. Ct. Rep. Mr. Justice Cardozo stated that a pledge perfected *more than four months preceding bankruptcy* was not subject to an attack by the trustee in bankruptcy *in absence of proof that the pledge was fraudulent in its inception against the bankrupt's creditors.*

IV.

The decision of the Court of Appeals cannot be reconciled with the decision of this Court in the leading case of *Pepper v. Litton,* 308 U. S. 295, 60 S. Ct. 238 (cited and

reaffirmed in numerous subsequent federal decisions and explicated by the United States District Court for the Eastern District of Michigan in *In re Cable-Link Corporation*, 135 Fed. Supp. 277, 287) wherein Mr. Justice Douglas speaking for this Court declared that a bankruptcy court in the exercise of its broad equity powers fortified by Sections 2 and 57(k) of the Bankruptcy Act has the undoubted power to allow, or to disallow, *or to subordinate general* claims of creditors to other claims "according to the equities of the case" and "in light of equitable considerations."

V.

The decision of the Court of Appeals is in direct conflict with the decision of the Court of Appeals for the Third Circuit *In re Consorto Construction Co.*, reported in 212 F. 2d 676, wherein the Court of Appeals for the Third Circuit decided that a chattel mortgage recorded *more than four months preceding bankruptcy* is not subject to an attack by the trustee in bankruptcy for the benefit of the creditors of the bankrupt who came into existence after the recordation of the chattel mortgage.

VI.

The failure by the Court of Appeals to invoke the doctrine of equitable estoppel *in pais* against the bankrupt's late creditors (who had constructive knowledge of petitioners' superior mortgage lien) and against the trustee (who stood in their shoes) which doctrine is consistently and uniformly invoked in equity is an unwarranted departure from the accepted and usual course of judicial proceedings in equity. The failure by the Court of Ap-

peals to grant the alternative request of petitioners in their petition for rehearing for subordination of the claims of the bankrupt's late creditors to the claims of the petitioners and to the claims of the bankrupt's creditors who were in existence prior to the recordation of the chattel mortgage is equally an unwarranted departure from the accepted and usual course of proceedings in equity; and it is also out of harmony with the letter and spirit of Sections 2 and 57(k) of the Bankruptcy Act.

VII.

The questions presented for review involve the construction and interpretation of important sections of the Bankruptcy Act in their application to the basic facts and equities presented by the record herein and in light of the applicable California statutes. As stated in the memorandum decision of the Referee the position of the trustee of bankruptcy was one "which literally shocked the conscience of the Referee;" such was not gainsaid by the District Court, and the inequitable position of the trustee in bankruptcy was commented on unfavorably in the opinion of the Court of Appeals as "a windfall of $82,500.00." The precise point whether a chattel mortgage *recorded more than four months preceding bankruptcy* is vulnerable to an attack by a trustee in bankruptcy for the benefit of creditors who came into existence after the recordation of a chattel mortgage has not been adjudicated in the *Moore* decision; and this important question of federal bankruptcy law has not been, but should be settled by this Court. A court of bankruptcy is a court of equity exercising equitable powers of broad sweep; and a bank-

ruptcy court may exert such powers in full vigor *with respect to the allowance, rejection and subordination of claims.* A court of bankruptcy is empowered to sift the circumstances surrounding any claim to see that injustice and unfairness is not done in the administration of the bankruptcy estate (*Cf. Rader v. Boyd*, 252 F. 2d 585, at p. 586). These equitable principles were not considered by the Court of Appeals in the case at bar, and the tell-tale equities of the petitioners were not respected Sections 70(c), 70(e) and 60 of the Bankruptcy Act (on which the opinion of the Court of Appeals was anchored) must not be read in isolation, but must be read in conjunction with the other and related sections of the Bankruptcy Act, and Section 57(k) of the Bankruptcy Act; they must be also read in light of the equitable philosophy embedded in the Bankruptcy Act. It is inconceivable that it was the intent or policy of Congress to dilute or to curb the equity powers of a bankruptcy court and to delete Section 57(k) of the Bankruptcy Act. Under the opinion of the Court of Appeals the late creditors would become unjustly enriched; and under the California law such creditors are not in the same category or class with petitioners.

Summary of Argument.

This Summary of the Argument is presented in amplification of the reasons relied on for the allowance of the writ of certiorari *supra*.

I.

Under the California Law (Which Governs the Substantive Property Rights of a Mortgagee) Creditors of a Mortgagor Coming Into Existence After the Recordation of a Chattel Mortgage Cannot Attack Its Validity on the Basis of Its Prior Delayed Recordation.

This substantive California law was conceded by the District Judge [R. p. 57, Conclusions of Law II and III]; and same finds support in numerous California decisions some of which were cited by the Court of Appeals for the Ninth Circuit in:

Swift v. Higgins, 72 F. 2d 791;

Bank of California v. Sampsell, 114 F. 2d 211.

This California *Substantive* law was not affected by the Bankruptcy Act; instead it was adopted in Section 60 and Section 57 (g) 70 (e) of the Bankruptcy Act.

II.

The Opinion of the Court of Appeals Is Premised on an Impermissible Interpretation of the Precise and Narrow Holding of This Court in the Moore Decision. The Moore Decision Attacked the Validity of a Chattel Mortgage Which Was Conclusively Fraudulent and a Nullity in Its Inception Under the California Civil Code Section 3440 Then in Force.

In view of the apparent breadth of the views of the Court of Appeals on the decision in the *Moore* case under the doctrine of *stare decisis* (which doctrine petitioners pause to observe is not inflexible but is *adaptable and adjustable* to changed and fresher concepts of justice and fairness), it may promote a correct analysis of the *Moore* decision to emphasize at the outset what it did not involve.

The *Moore* decision did not involve a chattel mortgage which *was valid in its inception* under the California law; nor did it involve a chattel mortgage which was recorded more than four months preceding bankruptcy and when the mortgagor was solvent; nor did it attack the validity of a chattel mortgage on the ground of its late recordation under California Civil Code Section 2957; nor did it discuss the problem whether the trustee in bankruptcy could attack the validity of a chattel mortgage for the benefit of creditors who came into existence after the recordation of a valid chattel mortgage *more than four months preceding bankruptcy* and during the solvency of the mortgagor; nor did it discuss the application of the equitable doctrine of estoppel *in pais*, against subsequent creditors; nor did it discuss the application of the equitable doctrine of subordination fortified by Sections 2 and 57(k) of the Bankruptcy Act; nor did it discuss the application of the equitable doctrine precluding unjust enrichment by creditors who had notice of an existing superior chattel mort-

gage lien and who extended credit to the bankrupt in their awareness of the existing superior chattel mortgage lien; nor did it involve a shocking and unconscionable course of conduct such as depicted by the Referee in his memorandum decision.

The critical facts on which the *Moore* decision was premised are stated fully in the opinion of the Court of Appeals for the Ninth Circuit *In re Sassard Kimbal, Inc.*, reported in 45 F. 2d 449. The mortgage therein attacked *was conclusively fraudulent in its inception and was a nullity under California Civil Code Section 3440 then in* force (see App. D). No notice of intention to take a mortgage on the property of the mortgagor (the bankrupt) was recorded or filed *prior to the execution of the chattel mortgage;* and the chattel mortgage was therefore *conclusively fraudulent* against the existing creditors under the express and mandatory provisions of Section 3440 of the California Civil Code. The chattel mortgage involved in the *Moore* decision was *a nullity under the California decisions* (*Cf. Mitchell v. Setzler*, 84 Cal. App. 2d 716, at page 720) *under which the mortgagee did not acquire any rights in the mortgaged property.* (*Cf. Mallaquras v. Novo*, 59 Cal. App. 2d 225, at page 231.) Furthermore the opinion in the *Moore* decision does not indicate *whether* the notice of intention was recorded either within or more than four months before bankruptcy.

Petitioners respectfully submit that the statement in the opinion of the Court of Appeals (263 F. 2d at page 515) that the *Moore* case and this case cannot be distinguished "in principle" is erroneous. One has to look hard and far to find any semblance of analogy of the factual context in the *Moore* decision to the equitable factual context in the present record.

III.

A Chattel Mortgage Recorded More Than Four Months Preceding Bankruptcy Is Not Vulnerable to an Attack by a Trustee in Bankruptcy for the Benefit of Creditors Who Came Into Existence After the Recordation of a Chattel Mortgage in Absence of Proof That the Chattel Mortgage Was Fraudulent in Its Inception Against Creditors.

Buffum v. Barceloux Co., supra, (289 U. S. 227) was a plenary action instituted by a trustee in bankruptcy to declare null and void a pledge executed by the bankrupt followed by a secret sale thereof for much less than its fair value. The evidence was that the pledge was fraudulent *in its inception* and a chain in a general plan conceived by the bankrupt to defraud the bankrupt's creditors. The action was brought under Section 70(e) of the Bankruptcy Act (11 U. S. Code, par. 110). The court sustained the findings of the District Judge that the pledge was fraudulent *in its inception. On that ground* the decree of the District Court for the trustee was affirmed, and in support thereof the *Moore* decision was cited. At page 232 (289 U. S.) the court stated that the evidence sustained the findings of the District Court that the pledge was made to defraud the creditors, but *that if no fraud had been intended,* "the pledge would be proof against attack, *for it was made* more than four months before the bankruptcy petition." (Italics added.)

In *In re Consorto Construction Co.,* 212 F. 2d 676, the Court of Appeals for the Third Circuit decided that a chattel mortgage recorded more than four months before

bankruptcy is not vulnerable to an attack by the trustee in bankruptcy for the benefit of the creditors who came into existence after the recordation of the mortgage either under Section 70(c) or 70(e) of the Bankruptcy Act. This decision makes a realistic and common sense approach to the precise problem presented by the record in the case at bar; and for the convenience of the Court we quote from it in Appendix "F."

The decision of the Court of Appeals for the Eighth Circuit in *Mercantile Trust Co. v. Kahn*, 203 F. 2d 449 (relied on by the Court of Appeals in its opinion) did not involve the rights of subsequent creditors under a mortgage *recorded more than four months before* bankruptcy.

The realistic and logical approach made by the Court of Appeals for the Third Circuit in *Consorte, supra*, (see App. F) was not made by the Court of Appeals for the Second Circuit in *Constance v. Harvey* reported in 215 F. 2d at page 571; and the opinion in the *Constance* case *supra* indicates an apparent conflict between the decisions of the Courts of Appeal for the Third and the Second Circuits. Moreover, the opinion of the Second Circuit in the *Constance* case *supra* was predicated on the court's interpretation of the policy established by the decisions of the State of New York bearing on the legal effect of Paragraph 230 of the New York Lien Law (see page 575 of the decision).

The decision in *Constance, supra*, was not followed by the New Jersey United States District Court in *Matter*

of American Textile Printers Co., 152 Fed. Supp. 901, on the ground that the New York State policy was not comparable with the policy adopted by the State of New Jersey (page 901 of the decision).

The opinion of the Referee *In re Pierro*, 159 Fed. Supp. 497 states in footnote 2 at page 498 that the decision in *Constance, supra*, has been widely criticized and not followed in other districts and cities in support thereof the following: Seligson, Annual Survey of American Law, Bankruptcy, 30 N. Y. U. L. Rev. 558 (1955); Seligson, Creditors' Rights, 32 N. Y. U. R. Rev. 708 (1957); Marsh, Constance v. Harvey—The "Strong-Arm Clause" Evaluated, 43 Calif. L. Rev. 65 (1955); Levin and Weintraub, The Strong-Arm Clause Strikes The Belated Chattel Mortgage, 25 Fordham Law Review 261. In said footnote the Court further stated that with all due respect to the Second Circuit, this Court concurs with this criticism and therefore follows the traditional interpretation of the rights of a trustee under Section 70, sub. e.

The decisions cited in 4 Collier in Bankruptcy Par. 70.95 at pages 1533-1536 to the effect that the *Moore* decision is operative in cases involving a delayed recordation of a chattel mortgage do not deal with mortgages *recorded more than four months before bankruptcy*; nor do they discuss the common sense rule announced by the Third Circuit in the *Cosorto* case *supra*; nor do they make reference to the *Buffum* decision *supra* (289 U. S. 227); nor do they comment on the application of Section 57(k) of the Bankruptcy Act.

IV.

Bankrupt's Subsequent Creditors Were Charged With Notice and Knowledge of Petitioners' Superior Mortgage Lien, Which Has Been Perfected More Than Four Months Before Bankruptcy; and They Were Aware of the Existence of Petitioners' Superior Mortgage Lien When They Extended Credit to the Bankrupt. In Equity and Good Conscience Their Claims Must Be Subordinated to Petitioners' Mortgage Lien.

In *Pepper v. Litton*, 308 U. S. 295, 60 S. Ct. 238, Mr. Justice Douglas, speaking for the court declared:

> "The bankruptcy courts have exercised these equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates. They have been invoked to the end that fraud will not prevail, *that substance will not give way to form, that technical considerations will not prevent substantial justice from being done.* By reason of the express provisions of §2 these equitable powers are to be exercised on the allowance of claims, a conclusion which is fortified by §57, sub. k, 11 U. S. C. A. §93 sub. k, 12. For certainly if, as provided in the latter section, a claim which has been allowed may be later 'rejected in whole or in part, according to the *equities of the case*,' disallowance or *subordination in light of equitable considerations* may originally be made." (Emphasis ours.)

In *Bank of America v. Erickson*, 117 F. 2d 896, the Court of Appeals for the Ninth Circuit declared at page 898:

> "The bankruptcy court has undoubted power to subordinate a general claim to other claims in the

same category *where for any reason, legal or equitable, it ought to be subordinated.*"[4] (Italics supplied.)

In *Kader v. Boyd*, 252 F. 2d 585, the Court said at page 586:

> "A court of bankruptcy is a court of equity, exercising equitable powers of broad sweep. And, within the statutory scheme, the Court may exert such powers in full vigor with respect *to the allowance, rejection or subordination of claims.* It is empowered to 'sift the circumstances surrounding any claim *to see that injustice and unfairness is not done in the administration of the bankruptcy estate.*'". (Italics added.)

The equitable rule of subordination enunciated in the *Pepper* decision *supra* was made explicit in *In re Cable-Link Corporation*, 135 Fed. Supp. 277. At page 281 the Court said:

> "It is true that in the Pepper case the court exercised its equitable power to defeat a fraudulent scheme, but it must be kept in mind that equitable estoppel can be established without actual fraud or a fraudulent intent. (Citing cases.)
>
> "A court of bankruptcy, in the exercise of its broad equitable powers, *may apply the equitable doctrine of estoppel in pais.* (Citing cases.)

---

[4]As noted *supra* under the California decisions creditors coming into existence after the recordation of a chattel mortgage are not in the same category with a mortgagee.

V.

The Equitable Doctrine Precluding Unjust Enrichment Govern the Inequities of the Trustee's Petition Comprehensively Discussed in the Decision of the Referee.

The doctrine precluding unjust enrichment has been settled in the recent California decisions cited in *Bensinger v. Davidson,* 147 F. Supp. 240 at 247. As stated by Judge Carter in the last cited case at page 247:

> "We think the California cases rest on the principle of 'unjust enrichment' and the policy of the law against forfeitures. This language runs through the California cases. We therefore approach the problem on equitable principles. Has Bensinger been unjustly enriched, and if so, by how much?"

In Restatement of the law on Restitution, par. 160(c) at page 642, it is stated:

> "c. UNJUST ENRICHMENT. A constructive trust is imposed upon a person in order to prevent his unjust enrichment."

In Restatement of the law on Security, par. 59(c) at page 160, it is stated:

> "c. EQUITABLE LIEN. The term 'lien,' in its broadest sense includes equitable liens, which do not depend upon possession. Equitable lien is defined in the Restatement of Restitution, §161, as follows: 'Where property of one person can by a proceeding in equity be reached by another as security for a claim on the ground that otherwise the former would be unjustly enriched, an equitable lien arises.' "

Pomeroy in Equity Jurisprudence, in interpreting the maxim that he who seeks equity must do equity said in Section 385:

> "That whatever be the nature of the controversy between two definite parties, and whatever be the nature of the remedy demanded, the Court will not confer its equitable relief upon the party seeking its interposition and aid, unless he acknowledge and concede, or will admit and provide for, all the equitable rights, claims and demands justly belonging to the adverse party and growing out of or necessarily involved in the subject matter of the controversy."

The equitable constructive trust doctrine was invoked *against the trustee in bankruptcy* in the decision rendered by Judge Oliver J. Carter of the United States District Court for the Northern District of California, on April 1, 1959, *In re Newcomb Interests, Inc.*, reported in Volume 171, No. 5, of Federal Supplement, at page 704. It is petitioner's contention that the equities against the trustee in bankruptcy involved in the *Newcomb* bankruptcy case are parallel with the petitioner's equities on the present record in the case at hand. (See Appendix "G".) In the *Newcomb* case a written sales contract was made by owners of a hotel as sellers and the bankrupt as purchaser providing for a transfer by the sellers to the bankrupt of the sellers' liquor license, and providing further for a re-transfer thereof by the bankrupt to the seller upon the bankrupt's default in the payment of the purchase price which was secured by a recorded chattel mortgage. The Court held that the agreement obligating the bankrupt on his default to re-transfer the liquor license to the sellers imposed on the bankrupt a constructive *trust* lien under the California decisions, and such lien was binding upon and operative against the trustee in bankruptcy (p. 707 of the decision).

VI.

Petitioners' Repossession of the Located Mortgage Property Was Lawful Under the Federal Rule Stated in Appendix E. Their Repossession Did Not Give Rise to an Action in Conversion; and the Affirmative Judgment Against Petitioners in the Sum of $82,500.00 Cannot Be Sustained.

Passing over the point that the court below lacked summary jurisdiction to render an affirmative judgment (which point was raised by petitioners in the District Court as pointed out earlier in this petition), under the California law petitioners have acquired a property interest in the mortgaged chattels on the date of the execution of the chattel mortgage on June 1, 1954 (eight months before bankruptcy) (*Estate of McLaughlin*, 97 Cal. App. 484, 485; *Bank of California v. McCoy*, 23 Cal. App. 2d 192, 195). They also had a property interest therein as prior owners thereof. Petitioners were therefore legally entitled to take possession of the chattel mortgage property upon Delcon's default under the Federal rule stated in Appendix "E;" the challenged affirmative judgment deprived petitioners of their property interest in the mortgaged chattels in violation of the substantive due process of law ingrained in the Fifth Amendment to the United States Constitution. Petitioners had also the legal right to take possession *of their own property* in light of the equities discussed in the decision of the Referee and in Appendix "G".

Conclusion.

We wish to preface this conclusion with the restatement of the well settled rule that court opinions do not rest on abstract principles having no relation to the factual context; and court opinions must be read in the light of

the precise legal and equitable problems before the Court in their application to the facts and equities therein involved.

We believe the answer to the erroneous views of the Court of Appeals is supplied by the learned and experienced Referee in his scholarly decision, wherein the underlying equity philosophy of the Bankruptcy law is comprehensively analyzed, and the inapplicability of the *Moore* decision to the problems presented by the record is lucidly pointed out. We submit that the Referee's decision is sound; that it comports with the concept of justice and fairness, the bedrock on which the equity structure of the bankruptcy law was erected by Congress; that the decision of the Referee merits consideration by this Honorable Court, and it should be adopted by this Court.

Clearly, the reliance by the Court of Appeals on Section 60 of the Bankruptcy Act (preference section) was misplaced, since petitioners' chattel mortgage was recorded more than four months before bankruptcy, and in addition thereto, the bankrupt was solvent on the date of its recordation. *Buffum supra* (289 U. S. 227); and for the same reason the reliance by the District Court on Section 57(g) of the Bankruptcy Act [R. p. 58] was equally misplaced.

We respectfully contend that the opinion of the Court of Appeals did not make a realistic appraisal of the precise and narrow problem adjudicated in the *Moore* decision, and it stretched its construction and was unrealistic in its application to the problem and equities posed by the present record.

The opinion of the Court of Appeals spreads a chilling cloud over and around the equity powers of the Bankruptcy Court, and conducts an inquest over its equity

powers governing allowance, or disallowance, or subordination of claims according to the equities of the parties and in light of the equity considerations emphasized in the decision of the Referee and in the decisions cited herein.

We do not believe that it was the intent of the *Moore* decision to abrogate and nullify the equity doctrine of estoppel *in pais against creditors who had knowledge of petitioners' superior mortgage lien, or to abrogate and nullify the equity doctrine precluding unjust enrichment of such creditors.*

Our research failed to find any decision of this court sanctioning an abdication by a bankruptcy court of these well settled and accepted equity principles which deny to a trustee in bankruptcy the right to attack the validity of a valid chattel mortgage *recorded more than four months before bankruptcy for the benefit of the subsequent creditors of the mortgagor who, under the applicable California law, are estopped from attacking its validity on the ground of its prior delayed recordation.*

We respectfully pray that this Honorable Court assume jurisdiction to settle these all important bankruptcy questions in their application to the present record; and to resolve the existing conflicts between the Courts of Appeals pointed out in this petition; that this Court issue a writ of certiorari to review the adverse judgment of and decision of the Court of Appeals and to reinstate the judgment of the Referee.

Respectfully submitted,

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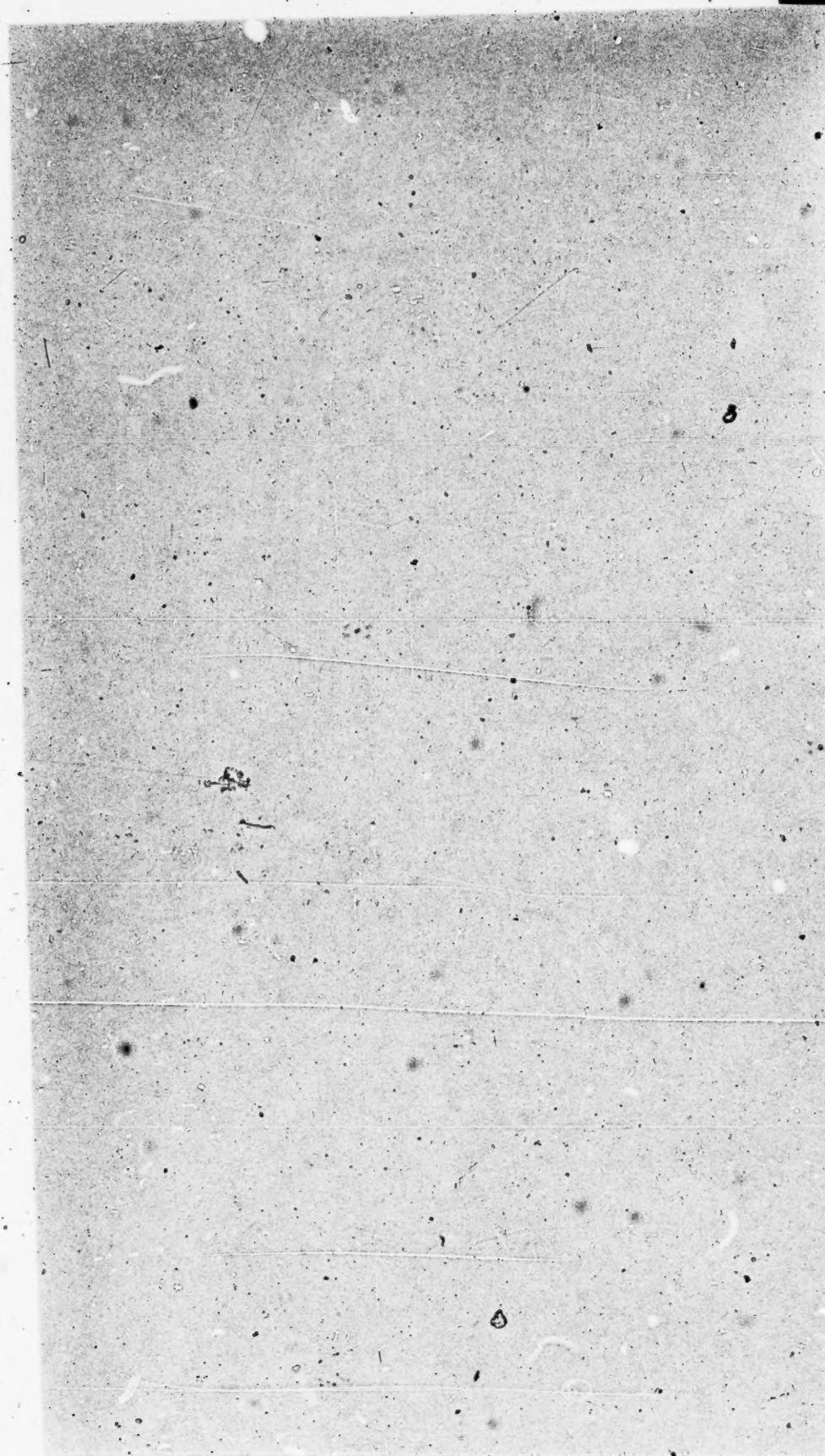
Of Counsel.



APPENDIX "A."

Opinion of the United States Court of Appeals for the Ninth Circuit.

United States Court of Appeals for the Ninth Circuit.

Elias Miller, Paul Miller, Anna Miller and Helen Miller, and Elias Miller and Paul Miller, as executors of the estate of George Miller, deceased, Appellants, vs. Irving Sulmeyer, trustee in bankruptcy of the estate of Delcon Corporation, bankrupt, Appellee. No. 15,781.

Jan. 16, 1959.

Appeal from the United States District Court for the Southern District of California; Central Division.

Before: STEPHENS, CHAMBERS and BARNES, Circuit Judges.

CHAMBERS, Circuit Judge:

The Millers sold a business in June, 1954, to the now bankrupt Delcon Corporation. They took back from Delcon a purchase money mortgage on chattels transferred to Delcon. There was a 79 day delay in recording of the chattel mortgage. This failure of the Millers to record was due to the negligence of a "trusted employee" who was apparently too busy with his defalcations of his employers' cash to attend to routine business.[1]

Eventually in December, 1954, under the terms of the mortgage the Millers repossessed the chattels and resold

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[1]California Civil Code Section 2957 reads as follows:

"A mortgage of personal property . . . is void as against creditors of the mortgagor and subsequent purchasers and encumbrancers of the property in good faith and for value, unless

. . . . . .

"4. The mortgage, if of personal property other than crops growing or to be grown or animate personal property, is recorded in the office of the recorder of the county where the property mortgaged is located at the time the mortgage is executed . . ."

the property in March, 1955, for $82,500. All agree this was a fair price.[2]

Delcon was insolvent at the time of the repossession, but solvent at the time of execution of the mortgage. The Millers filed a claim with trustee Sulmeyer for $141,742.50. This was mainly the balance due on the original note and mortgage which were in the amount of $189,000. Objections were made to the whole claim by the trustee. He asserted that by superimposing the bankruptcy act on the California state law the trustee had a right first to recover the proceeds of the sale of the chattels after which the claim could be allowed.

At the time of hearing before the referee there were on file claims for $8,906.95 (including some $7,863.64 due to the ubiquitous director of internal revenue) which originated prior to the filing date of August 19, 1954, for the chattel mortgage, but probably after the date of the mortgage. All other creditors apparently postdated the recording date.

The referee ruled that the Millers must repay the sum of $8,906.95, at which time they could have their claim for $141,742.50 allowed along with a supplemental claim in the amount of $8,906.95, both items to be general and unsecured claims. On review, the district court directed the referee to enter judgment against the Millers for $82,500 (less certain small credits). Upon payment thereof the Millers were to have their claim of $141,742.50 allowed as well as a supplemental claim for $82,500, all as unsecured claims. From this heavy blow, the Millers have appealed.

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[2]The petition of three creditors for an adjudication of involuntary bankruptcy of Delcon was filed on February 23, 1955. The adjudication was made by the referee on March 16, 1955.

And, so the question here is whether the trustee is entitled to this windfall of $82,500. If so, the result is that the Millers originally sold their property without getting any security. This court is of the opinion, try as it may to reach a different result, that the case of Moore v. Bay, 284 U. S. 4 (reversing In re Sassard & Kimball, 9 Cir., 45 F. 2d 449) controls and that the district court must be affirmed. Cf. Mercantile Trust Co. v. Kahn, 8 Cir., 203 F. 2d 449.

All agree that but for the interposition of the bankruptcy adjudication the Miller repossession and sale under California state law would be impeccable as against creditors of Delcon becoming such after August 19, 1954. It would seem equally clear that creditors whose debts originated in the delayed period of 79 days under California law might have attacked the mortgage—here to the extent of $8,906.95.

The following extracts from the bankruptcy act should be quoted:

11 U. S. C. §110(c) (Bankruptcy Act, §70(c).):

"The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, *whether or not such a creditor actually exists.*" (Emphasis supplied.)

11 U. S. C. §110(e)(1), (Bankruptcy Act, §70(e)(1):

"A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent

as against or *voidable* for any other reason *by any creditor* of the debtor, having a claim provable under this Act, *shall be null and void as against the trustee of such debtor.*" (Emphasis supplied.)

11 U. S. C. §96, (Bankruptcy Act, §60):

"(a)(1) A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class.

* * *

"(b) Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent."

It is true, as the Millers say, the infirmity in the California chattel mortgage in Moore v. Bay, *supra*, was slightly different. There it was failure to give the required statutory notice of intention to give a chattel mortgage. However, this court finds itself unable to distinguish that case and the Millers' case in principle.

While the members of this court might belong to the legislative school that would vote to require trustees to take over rights as the state left them, still it is well settled that bankruptcy statutes can do more. And it would appear the sections above quoted do pick up the California state law, use it as a springboard and go beyond it. Sec-

tion 70(e)(1) says if any creditor could knock out the "transfer" as to him, the transfer is void as to the trustee. Section 70(c) only requires a hypothetical creditor not a real one. And Section 60 does nothing to weaken the other two sections. It buttresses them.

The Millers attack the constitutionality of the sections as here interpreted to take away from them their $82,500. Those things are constitutional which the Supreme Court says are constitutional. The point is answered by that court in Wright v. Union Central Ins. Co., 304 U. S. 502.

The Millers belatedly made three other points. The first is that the delay was excusable. The fact that the employee was simultaneously embezzling other assets is no excuse. None other is suggested.[3] Second, it is argued that purchase money mortgages are exempt. The language of §2957 of the California Civil Code is all inclusive. The general rule elsewhere is against the Millers and no persuasive California authority is cited for the idea.[4] Thirdly, it is suggested that the repossession before bankruptcy cured the infirmities. This might be true in

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[3]While California does not require instantaneous recording, it does require that it be recorded as soon as practicable. And there is no California case which has upheld anything like a 79 day delay. See Wolpert v. Gripton, 213 Cal. 474, 2 P. 2d 767, and Williams v. Belling, 76 Cal. App. 610, 245 P. 455.

[4]The court does not consider the situation in In re Mercury Engineering, (S. D. Cal.) 68 F. Supp. 376, to be parallel. There the district court determined that according to California law it was not necessary in the case of a purchase money mortgage to comply at all with §3440 of the California Civil Code requiring the filing of advance notice of intention to give a chattel mortgage. Therefore, the bankruptcy sections do not come into operation. Surely California would not hold that a purchase money chattel mortgage need never be recorded. The reason is that a large amount of apparently unencumbered assets permits a false appearance of economic health if they are in fact encumbered. In such circumstances general creditors would think at least that there was a substantial fund for all general creditors.

some states, but the California rule appears to be against the Millers on the point. Noyes v. Bank of Italy, 206 Cal. 266, 274 P. 68.

While it may be said that the state laws imposing penalties for failure to record instruments are drastic enough without superimposing additional federal sanctions, still the sanctions were written by the Congress and this court must give effect to them, harsh as they seem to be here.

While the brief for appellants is an able one, this court just cannot get away from the proposition that if the mortgage was subject to attack under California law by any creditor or even by the creditor who wasn't, but who might have been, then the bankruptcy act and Moore v. Bay, *supra*, permit the trustee to demolish the creditor's security although partially valid under state law (or even wholly valid in some circumstances because of the absence in fact of a certain type of creditor).

The order subject to this appeal is affirmed.

(Endorsed:) Opinion. Filed Jan. 16, 1959.

Paul P. O'Brien, Clerk.

APPENDIX "B."

Judgment.

Appeal from the United States District Court for the Southern District of California, Central Division.

This cause came on to be heard on the Transcript of the Record from the United States District Court for the Southern District of California, Central Division, and was duly submitted.

On consideration whereof, it is now here ordered and adjudged by this Court, that the Judgment of the said District Court in this cause be, and hereby is affirmed.

(ENDORSED) Judgment

Filed and entered: January 16, 1959

PAUL P. O'BRIEN, Clerk

APPENDIX "C."

Order Denying Petition for Rehearing.

On consideration thereof, and by direction of the Court, IT IS ORDERED that the petition of Appellants, filed February 13, 1959, and within time allowed therefor by rule of court for a rehearing of the above cause be, and hereby is denied.

APPENDIX "D."

1. California Civil Code Section 2957 (Deering's) at page 488, reads in pertinent part that a mortgage of personal property is void as against creditors of the mortgagor and subsequent purchasers and creditors and encumbrancers of the property in good faith and for value

2. California Civil Code Section 3440 (Deering's) at page 624, in force prior to 1953, provided in pertinent part that *unless a notice of an intended chattel mortgage was recorded at least 7 days prior to its execution or filing, the chattel mortgage will be conclusively presumed to be fraudulent and void as against creditors.* This section was in force when the *Moore* decision, *supra,* was rendered by this Court (284 U. S. 4). In 1953 this section was amended by adding thereto Section 3440.1 providing, *inter alia* for a notice of at least 10 days (instead of seven days) prior to the execution of the chattel mortgage. (Italics supplied.)

APPENDIX "E."

In his unreported opinion in the Bankruptcy matter pending in the United States District Court, Southern District of California, Central Division, No. 18334-BH, United States District Judge Mathes declared the applicable federal rule of law to be as follows:

> "There is no dispute but that the chattel mortgages and conditional sales contracts were valid and were entered into more than four months before bankruptcy. If in default there can be no question, then, of defendant's right to foreclose its security according to the terms of the contracts and mortgages *up to and within four months of the date of bankruptcy*. (See the discussion and authorities cited in MacLachlan on Bankruptcy Section 216 (1956); and see also the discussion in *Straton v. New*, 283 U. S. 318, 325-326 (1931).) (Italics added.)
>
> "In other words, since the contracts and mortgages were executed, were admittedly valid and were executed more than four months prior to bankruptcy, the security could be foreclosed *within the four-month period* just the same as it could be prior to the commencement of the four-month period." (Italics added.)

In 4 Remington on Bankruptcy at page 441, Paragraph 1728.3, it is stated:

"A chattel mortgage usually gives the mortgagee the right to take possession of the property mortgaged and to foreclose in case of default, and the chattel mortgage statutes in many states make possession of the property by the mortgagee equivalent to recording of the mortgage, either directly, or by providing that the mortgage shall not be effective as against creditors unless accompanied by change of possession, etc. The mortgagee, by coming lawfully into possession of the property *before filing of the bankruptcy petition,* can accordingly, under such provisions, perfect his rights as against the rights of the trustee in bankruptcy of the mortgagor under §70(c) of the Act." (Italics supplied.)

APPENDIX "F."

Excerpt From Opinion in In re Consorto Construction Co., 212 F. 2d 676, at 679.

"There are other statutes, notably those of California and New Jersey, which state no time for recording yet are construed to require immediate recording in order for the instrument to be valid even though they do not, like the Missouri statute, relate the lien back to the execution date. (Citing California and New Jersey decisions.) Courts which adopt this construction seem to be persuaded that there is a danger of imposition on unsecured creditors of the mortgagor if a delayed filing is held to create a lien even from the time of recordation. *But the same result can be obtained merely by re-executing the old unrecorded mortgage and recording this 'new' instrument at once. It seems worthless formalism to require such re-execution of the old instrument as a basis for effective recordation.* (Italics added.) We think that a chattel mortgage while unrecorded can be fairly recognized as having a potential like a pledge, originally ineffective for failure to deliver possession. In the latter situation, a subsequent delivery will generally perfect the pledge except as to bona fide purchasers or creditors who have acquired liens prior thereto. Brown, Personal Property, Sec. 128. Under the 1945 Pennsylvania Chattel Mortgage Act, we believe it to be the proper construction that a tardy recording will perfect the lien of a chattel mortgagee as of the date of recordation.

"Here the chattel mortgagee obtained a lien August 3, the date of recording. Anyone subsequently obtaining an interest in or claim against the property was subordinated to that lien. Under Section 70, sub. c the trustee's position is that of such a subsequent lienor, 'holding a lien

* * * by legal or equitable proceedings' as of the date of bankruptcy, a time more than four months after Equity (the mortgagee) perfected its mortgage lien.

"The trustee is in no better position under Section 70, sub. e which provides:

"A(n) * * * obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fraudulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor."

Under this subdivision the trustee is subrogated to the rights *of existing creditors* as to whom the obligations of the bankrupt are voidable. (Italics added.)

APPENDIX "G."

Excerpts From In re Mercury Engineering Co., 68 Fed. Supp. 376:

At page 380:

"The claimant here, Arthur E. Barili, for a long time prior to June 26, 1943, owned and operated a machine shop at 722 North Broadway, Los Angeles, California. On that day he sold it as a going concern to Charles B. Taylor, * * * for a total sum of $16,000. Barili received $5,000 in cash and the balance was to be evidenced by a promissory note in the sum of $11,000 secured by a chattel mortgage upon the business, machinery and equipment sold. The chattel mortgage is undated, but was acknowledged on June 30th, and delivered to Barili. * * * During the week, Barili remained at the place of business. The following Monday, July 26th, the chattel mortgage was recorded."

* * * * * * * *

At page 378:

"* * * the chattel mortgage is first challenged because of failure to comply with Section 3440 of the California Civil Code * * *"

At page 379:

* * * * * * * *

"We need not go into a detailed discussion of this section. It has its duplicate in almost every state in the Union, including the State of New York. California Courts do not seem to have been called upon to determine whether its provisions apply *to a purchase price chattel mortgage*. But the referee rightly

concluded that it did not so apply upon no less an authority than the Circuit Court of Appeals for the Second Circuit whose opinions upon a matter of this character interpreting a New York statute of identical import with ours command not only respect, but require following when no contrary ruling in our own Circuit appears. *This is especially the case when the decision accords with the very philosophy which lies behind the enactment. Its object is to protect the creditors against a surreptitious sale or incumbrance of the chief assets or equipment of a trader. But when the incumbrance is to secure the moneys which represented the price of these assets, the reason for the requirement disappears. For to hold that the seller who, instead of receiving cash acquires a mortgage on property which he transfers to a buyer, must subordinate his rights to this buyer's other creditors, is to penalize him for supplying to the buyer the very means of carrying on a trade.* It would mean to subsidize the existing creditor who may have extended credit on the basis of ownership of other assets at the expense of the man who furnishes the stock in trade or equipment to carry on a business. When we require notice before sale of stock in trade, we do so in order that the basis on which the prior credit had been secured be not dissipated without notice. But when the basis did not exist, but came into being through the very sale and incumbrance, the very foundation for the requirement is gone. * * *" (Italics supplied.)